ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Dymally	Analyst:	Nicole Kwon	Bill Number:	AB 1134
Related Bills:	See Legislative History	Telephone:	845-7800	Introduced Date:	February 23, 2007
		Attorney:	Daniel Biedler	Sponsor:	

SUBJECT: Medical Enterprise Zones/Medical Enterprise Zone Hiring, Qualified Primary Care Residency Care Residency Program, & Sales & Use Credits

SUMMARY

This bill would designate ten new medical enterprise zones and allow various credits for those zones.

This bill would also amend some provisions of the Government Code and the Health and Safety Code; however, those provisions do not apply to the Franchise Tax Board (FTB) and this analysis addresses only those provisions of the bill affecting FTB.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide a greater incentive to promote primary health care in economically distressed parts of the state.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2008, and would apply to taxable years beginning on or after January 1, 2008.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal law provides for the existence of empowerment zones and enterprise communities to provide economic revitalization of distressed urban and rural areas.

Board Position:			Department Director	Date
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Under the Government Code, state law provides for several types of Geographically Targeted Economic Development Areas: Enterprise Zones (EZs), Manufacturing Enhancement Areas, Targeted Tax Areas, and Local Agency Military Base Recovery Areas.

Under the Government Code, existing state law allows the governing body of a city or county to apply for designation as an EZ. Using specified criteria, Department of Housing and Community Development designates EZs from the applications received from the governing bodies. EZs are designated for 15 years.

Under the Revenue and Taxation Code (R&TC), existing state law provides special tax incentives for taxpayers conducting business activities within EZs. These incentives include a hiring credit, sales or use tax credit, business expense deduction, net interest deduction, and special net operating loss treatment.

Hiring Credit: A business located in an EZ is eligible for a hiring credit equal to a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an EZ and meet certain other criteria. At least 90% of the qualified employee’s work must be directly related to a trade or business located in the EZ and at least 50% of the employee's services must be performed inside the EZ.

The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage (under special circumstances for the Long Beach EZ, the maximum is 202% of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer’s deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

Taxpayers operating in an EZ are allowed the hiring credit for employing “qualified employees.” “Qualified employees” for EZs are defined by reference to various state and federal public assistance programs. A taxpayer located in an EZ is allowed a credit of up to 50% of wages paid to “qualified employees” in the first year, decreasing by 10% each year thereafter. The taxpayer is required to obtain a voucher certificate for each of its “qualified employees.” The voucher certificates are issued by the Employment Development Department or the local (within the same EZ as the workplace of the employee) agency familiar with the public assistance statutes.

Sales or Use Tax Credit: The sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified machinery purchased for exclusive use in an EZ. Currently, the credit is for the total cost of qualified property purchased and placed in service in any taxable year. The total costs of qualified property may be in an amount not to exceed $1 million under the Personal Income Tax Law and to $20 million under the Corporation Tax Law.

THIS BILL

This bill would require the California Healthcare Workforce Policy Commission to designate ten "medical EZs" by December 1, 2008.

Under the newly designated medical EZs, this bill would create the following credits for taxable years beginning on or after January 1, 2008:

1. A hiring credit for "qualified taxpayers" who hire health care professionals to perform services within a medical EZ.
2. A sales or use tax credit for taxes paid or incurred on medical equipment purchased by the taxpayer. This bill would specify the following:
   - "Taxpayer" means a person or entity engaged in a trade or business that provides primary care services to be used exclusively within a medical EZ.
   - "Qualified property" means medical equipment up to a value of $100,000.
   - Qualified "medical equipment" is specified under the bill.
3. A qualified primary care residency training program credit of an unspecified percentage for "qualified taxpayers" who engage in providing, arranging, paying for, or reimbursing the cost of personal health care services. This bill would specify the following:
   - "Qualified amount" means the costs paid or incurred by a qualified taxpayer for the support of a qualified primary care residency training program.
   - "Qualified primary care residency training program" means a primary care residency training program located and operating in a medical EZ.

IMPLEMENTATION CONSIDERATIONS

This bill would raise the following implementation considerations. Department staff is available to work with the author's office to resolve the implementation concerns.

This bill is silent about what would happen to the provisions of this bill when a medical EZ designation expires, namely whether the taxpayer would be able to carryover the excess credit amount even though the medical EZ no longer exists.

Department staff currently has no expertise in primary health care services or health practitioners. The author's office may consider having another state agency with expertise in primary health care certify the taxpayers that are located in a medical EZ and provide primary care services as defined in the bill. The taxpayer could then be required to provide this certification to FTB upon request.

For purposes of the sales or use tax credit, the qualified property must be used exclusively in the medical EZ. The term "exclusively" implies that the property is used 100% in the medical EZ. If a doctor used any medical equipment in an emergency outside of the medical EZ, that equipment would no longer be qualified property. The author's office may want to amend the bill to specify that incidental use of medical equipment outside the medical EZ does not disqualify the property.

Medical equipment up to a value of $100,000 on page 13, lines 4 and 5 can be interpreted as either $100,000 in aggregated amounts of equipment or related to each individual equipment costs. The author's office may want to clarify the correct intention of the bill for the department to implement the provision of the bill.

The phrase "placed in service" should be defined to clarify whether the author's intention is to allow taxpayers to place the same equipment into a different medical EZ each year and thereby generate multiple sales or use credits on the same cost spent for equipment cost.

The apportionment language in this bill starts with total income rather than California total income currently used in the Geographically Targeted Economic Development Areas. In addition, payroll and property factors necessary to compute income in the medical EZ are not defined. The author's office may want to refer to the language in the current Geographically Targeted Economic Development Areas in the R&TC.

Qualified wages applies to the test to when an individual commences employment in the medical EZ, not with an employer. The author's office may want to add "first" before "day the individual commences" on page 15, line 7 to prevent the possible disputes between the taxpayers and the department on when qualified wage credits can be taken by the taxpayer.

The definition of "health care professional" is that the individual must relocate to a medical EZ. The term "relocate" could mean the individual changed either his/her place of residence and/or their place of employment. If "relocate" means a change in the place of employment, employees just entering the health care profession would be excluded from the credit. If "relocate" means a change in residence, the health care professional would be required to live in the medical EZ in order to qualify for the credit. The author's office might consider amending the bill to either provide a definition for "relocate" or to remove the requirement altogether.

<u>TECHNICAL CONSIDERATIONS</u>

There are a number of grammatical errors as well as the inconsistent language style used in the current R&TC found in the bill. For example, on page 13, line 32, the term "credit is used" should be replaced with "credit is exhausted."

The author's office indicated that the future amendments to the bill will take out every provision in the bill except the credit related to the primary care residency training program, which would eliminate the majority of the implementation and technical concerns.

LEGISLATIVE HISTORY

AB 3325 (Escutia, 1993/1994) was similar to this bill. AB 3325 would have created a hiring credit and sales or use tax credit under the newly designated medical EZs. AB 3325 did not pass out of Utilities and Commerce Committee.

OTHER STATES' INFORMATION

The states surveyed include *Illinois, Massachusetts, Michigan, Minnesota,* and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Although each of these states have economic development programs to encourage job growth, those programs are generally targeted to specific distressed areas or disadvantaged employees and are not comparable to the provisions of this bill.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this provision would result in the following unknown revenue losses.

Revenue Estimate for AB 1134 Effective for Tax Years BOA 1/1/2008 Assumed Enactment Date After 6/30/07			
	2007/08	2008/09	2009/10
Hiring credit	<$150K	<$500K	-$2 mil.
Sales or use tax credit	<$150K	<$500K	-$1.5 mil.
Residency-training program credit	Unknown	Unknown	Unknown

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

The revenue loss associated with the residency-training program credit is unknown because the percentage of credit amount allowed is unspecified.

Revenue Discussion

This bill would provide three credits for designated medical EZs: (1) hiring credit for health care professionals, (2) sales or use tax credit for qualified medical equipment, and (3) primary care residency training program credit. The bill specifies credit amounts for the first two as a percentage of paid wages or the amount of paid sales or use tax on each piece of equipment, valued up to $100,000. The creditable amount of primary care residency training program is unspecified and therefore the total revenue loss from this bill is unknown.

Hiring Credit:

The revenue impact of the hiring credit is dependent on the amount of wages paid during a year and the number of medical professionals hired to perform services within a medical EZ.

The medical EZ designation may be in an unincorporated or incorporated area. If the medical EZ is within an incorporated area, it must be designated as a Health Professional Shortage Area. For calendar year 2006, the U.S. Department of Health and Human Services (DHHS), designated 18 counties within California as Health Professional Shortage Areas (HPSA) of primary medical care. This database provides the number of full-time equivalent positions needed for designation. This number of positions does not represent the total number of anticipated employment in the area, such as other medical support services needed to maintain varied levels of care. Because of this, the total number of new jobs per medical EZ is dependent on each area's established network of available medical services/resources.

Based on DHHS data about HPSA designations, this estimate assumes that the 18 counties identified are potential medical EZs and that the top ten facilities with the greatest shortage are selected as medical EZs. The number of full-time equivalent positions identified by the DHHS for these ten designated county areas is 80 positions. This number of positions is tripled to account for an increase in related medical support services within the medical EZs, resulting in approximately 240 new positions within all medical EZs. Applying the wage limit of (150% of the minimum wage) or $12/hour ($8 minimum wage as of 1/1/08 x 150% = $12), total eligible wages for full-time employment would total $6.2 million (250 positions x 52 weeks/year x 40 hour work week x $12/hour). These wages are increased by 5% to $6.5 million to account for anticipated employee turnover within each medical EZ.

Of the eligible wages paid, for the first year of employment, the creditable amount is 50%; this percentage reduces by 10% for each subsequent year of employment (40% for year 2, 30% for year 3, 20% for year 4, and 10% for year 5). Applying this limit results in hiring credits of $3.2 million for 2008. Eligible wages for 2009 would include $2.6 million ($6.5 million x 40%), which is 40% of wages paid for employees hired in 2008 plus 50% of wages paid for employees hired during 2009. This estimate assumes that employment grows at 5% within each medical EZ for five years and would result in an additional $200,000 in credits for each subsequent year, bringing total credits for 2009 to $2.8 million ($2.6 million + $200,000).

Sales or Use Tax Credit:

The revenue impact of the sales or use tax credit is dependent on the amount and the value of equipment placed in service within a medical EZ.

Assuming that on average, total expenses for equipment per medical EZ, for each professional identified by DHHS is $500,000 per year for three years and that 80% or $400,000 ($500,000 x 80%) qualifies, the creditable amount are sales or use taxes paid on this amount. Assuming a sales or use tax rate of 7.75%, the annual credit would result in total losses of $2.4 million for all medical EZs, for three-years ($400,000 x 80 positions x 7.75%).

Summary:

Based on the assumptions presented above, the combination of the hiring credit and the sales or use tax credit for taxable year 2008 would total about $5.6 million ($3.2 million in hiring credit + $2.4 million in sales or use credit), $5.2 million for 2009 ($2.8 million in hiring credit + $2.4 million in sales or use credit) and $4.7 million for 2010.

The chart above assumes that the approval process and the designation of all medical EZs would be made during later part of 2008 and therefore only 10% of the losses derived for 2008 would be realized. Unused medical EZ credits would be carried over until exhausted. This estimate assumes that 60% of credits generated during a year would be used and the remaining would be carried over for three-years. The revenue estimate in the chart above reflects these assumptions and anticipated changes in estimated tax payments.

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